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In the Supreme Court of the United States

AMERICAN TELEPHONE & TELEGRAPH CO.
and
LUCENT TECHNOLOGIES INC.,

Petitioners,

v.

THE UNITED STATES,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

BRIEF OF THE NATIONAL DEFENSE INDUSTRIAL ASSOCIATION AND THE GOVERNMENT ELECTRONICS AND INFORMATION TECHNOLOGY ASSOCIATION AS *AMICI CURIAE* IN SUPPORT OF PETITIONERS

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INTEREST OF THE *AMICI CURIAE*[1]

Amicus curiae National Defense Industrial Association (NDIA) is a nonpartisan, nonprofit international organization representing more than 1000 companies and 24,000 individuals from the defense and national industrial bases. NDIA's mission is to provide a forum for the interchange of ideas between the government and industry to address problems of joint concern, including business and technical aspects of the government acquisition and procurement process. NDIA members support our national defense by contracting with the government to provide vital military equipment, weapons, and machinery.

Amicus curiae Government Electronics and Information Technology Association (GEIA) is an organization of "high-tech" companies that contract to provide the government with electronics and information technology solutions. Members of GEIA have thousands of contracts with the federal government and derive a substantial percentage of their annual revenues from these contracts.

NDIA and GEIA believe that the Federal Circuit's decision will prevent defense contractors, including members of *amici* organizations, from obtaining traditional and appropriate contract remedies when the contractors incur losses on illegal contracts or contracts with illegal terms. Some members of *amici* organizations face in other litigation the same issue that is before the Court in the petition.

STATEMENT

This litigation arises out of a contract entered into at the end of 1987 between petitioner AT&T, a defense contractor, and the United States Navy, to engineer and develop the "Reduced Diameter Array," a subsystem of the "Surveillance Towed-Array Sensor System," designed to detect the most advanced

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[1] The parties' letters of consent to the filing of this brief have been lodged with the Clerk of the Court. Pursuant to Rule 37.6 of the Rules of this Court, *amici curiae* state that no counsel for a party has written this brief in whole or in part and that no person or entity, other than the *amici curiae*, their members, or their counsel, has made a monetary contribution to the preparation or submission of this brief.

Soviet submarines. Pet. App. 34a-35a.[2] The contract was a "fixed-price" contract under which petitioner committed to do all research, development, and testing, and to deliver an "engineering development model." Petitioner successfully performed the contract at a total cost vastly in excess of the fixed contract price (even after certain adjustments). *Ibid.*

A completely lawful fixed-price contract, of course, would have placed on petitioner the risk that the cost of this cutting-edge research and development would be much more than the price. But the price term of contract at issue was *not* lawful, precisely because Congress was fed up with the Navy's practice of routinely putting such risks entirely on contractors. The fixed-price term in the contract violated the Defense Appropriations Act of 1987, Pub. L. No. 100-212, § 8118, 101 Stat. 1329-84 (Section 8118), which provided in part:

> None of the funds provided for the Department of Defense in this Act may be obligated or expended for fixed price-type contracts in excess of $10,000,000 for the development of a major system or subsystem unless the Under Secretary of Defense for Acquisition determines, in writing, that program risk has been reduced to the extent that reasonable pricing can occur, and that the contract type permits an equitable and sensible allocation of program risk between the contracting parties[.]

Petitioner sued in the Court of Federal Claims, seeking to have the contract reformed into a "cost reimbursement" contract, to correct the illegal price term. In the alternative, petitioner sought relief in *quantum meruit* for the value of the benefit conferred on the Navy. Pet. App. 109a.

The litigation ultimately made it to the *en banc* Federal Circuit, which held in an opinion by Judge Newman that the

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[2] Though both AT&T and Lucent Technologies are petitioners, there was only one contract, and we will refer to "petitioner" to avoid confusion. No issue before the Court turns on any difference in the interests of AT&T and Lucent.

illegal price term did not render the entire contract void *ab initio*. Pet. App. 48a. The court also stated the various remedies potentially available to a contractor that has fully performed its responsibilities under a contract that contains an illegal term, including sustaining the contract, reforming the contract, and granting recovery under an implied-in-fact contract. *Ibid.*

On remand, the Court of Federal Claims dismissed the suit for failure to state a claim. A Federal Circuit panel affirmed over a strong dissent by Judge Newman, the author of the *en banc* opinion. Pet. App. 2a. The panel held that petitioner's ability to bring a cause of action seeking a remedy on the contract turned on whether Section 8118 was intended to be "enforced" through private lawsuits. *Id.* at 8a. The panel also suggested that petitioner had waived any right to contest the price term in the contract by failing to protest the form of the contract during the bidding process. *Id.* at 13a-14a.

The unsettled state of the law within the Federal Circuit demonstrates a need for this Court to intervene. Because the complaint has been dismissed for failure to state a claim (after ten years of litigation), the petition presents a pure issue of law for this Court's review. This case is therefore an excellent vehicle for this Court to answer the simple, broadly applicable question whether an aggrieved contractor can pursue contract-law remedies when one or more terms of the contract are illegal.

ARGUMENT

I. REVIEW IS NEEDED TO ADDRESS THE CONFUSION REGARDING A CONTRACTOR'S RIGHT TO A REMEDY WHEN A CONTRACT OR ITS TERMS ARE INVALID

It is impossible to overstate the radical nature of the decision below. The panel majority did not hold that some *particular* contract remedy is unavailable *on the facts* of this case. Rather, it held that *all* contract remedies are unavailable unless the statute making a contract term illegal gives rise to an express or implied private right of action. No corresponding doctrine shackles the government's right to use self-help or otherwise

obtain relief when it discovers that *it* would be better off without an illegal contract term. This new doctrine that the contractor always (or almost always) loses when a contract contains an illegal term is alarming to *amici*, and provides disincentives for the government to adhere to the will of Congress when entering into any of an enormous variety of contracts.

When one side has fully performed its obligations under the contract, and the price term of the contract is illegal, it makes no sense to interpret *the statute rendering the term illegal* – rather than the Contract Disputes Act, which allows an aggrieved government contractor to sue – to determine whether the aggrieved contractor can sue *in contract or quasi-contract*. The panel below has – over a strong dissent by Judge Newman, the author of a prior *en banc* opinion in this same case – followed a train of reasoning that undermines the common law and the legal scheme understood and relied on by the defense contracting industry. In so doing, the panel created and applied special rules applicable only to government contracting, although this Court has recently noted that the United States is not exempt from the body of law that applies generally to contracts between private individuals. *Mobil Oil Expl. & Prod. Southeast, Inc.* v. *United States*, 530 U.S. 604, 607-608 (2000) (citing *United States* v. *Winstar Corp.*, 518 U.S. 839, 895 (1996) (plurality opinion)).[3]

The holding below breaks from this Court's decision in *Clark* v. *United States*, 95 U.S. 539 (1877), where a contractor

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[3] See also *Marathon Oil Co.* v. *United States*, 177 F.3d 1331, 1341 (Fed. Cir. 1999) (Newman, J., dissenting) (urging application of "simple contract principles" to hold government fiscally responsible for making contract impossible to perform), rev'd *sub nom. Mobil Oil Expl.& Prod. Southeast, Inc.* v. *United States*, 530 U.S. 604 (2000). Judge Newman's dissenting opinion in *Marathon*, disagreeing with Judges Plager and Rader, was issued 13 days before her *en banc* opinion in this case, disagreed with by Judges Rader (in concurrence) and Plager (in dissent). This Court vindicated Judge Newman's view. The issues in *Marathon* (*Mobil*) and this case are not the same, but in both cases Federal Circuit judges have advanced special rules to help the government escape ordinary contract doctrines.

was held entitled to *quantum meruit* recovery from the government when the express contract was unenforceable because it was not (as required by statute) in writing. The decision below also conflicts with the Federal Circuit's own recent decisions, including *Barrett Refining Corp.* v. *United States*, 242 F.3d 1055 (Fed. Cir. 2001), holding that *quantum valebant* recovery is available to a contractor that has fully performed a contract with an illegal price term. And the final panel decision below, which does not even follow the logical path on which the *en banc* court set the litigation, is the result of misguided attempts to apply a confused body of Federal Circuit case law. The inconsistency in rules regarding an aggrieved contractor's right to a remedy against the federal government, in the circuit with exclusive appellate jurisdiction over these cases, puts members of *amici* organizations out to sea with little confidence that the rules applied in one case can also be relied on in any future situation. The inconsistency will remain unless this Court grants review to clear up the confusion.

A. *Courts Regularly Replace Invalid Contract Terms with Implied Terms.* The process of discerning implied contract terms to supplant those that are invalid by operation of law has long been recognized. See *Clark*, 95 U.S. at 542 (allowing recovery "as upon an implied contract for a *quantum meruit*" for full performance of obligations under a contract that was unenforceable under a federal statute requiring military contracts to be in writing). This well-established doctrine, under which government contractors are subject to and may rely on the same body of contract law that regulates the dealings of private parties, has heretofore been the basis of the defense contracting industry's understanding of its legal rights in cases like the one before the Court. See *Winstar Corp.*, 518 U.S. at 895 & n.39 (plurality opinion) (citing cases).

Under the modern procurement contracting framework, the availability of a suit on a contract by an aggrieved contractor against the United States government is beyond cavil. The Tucker Act is an express grant of jurisdiction to the Court of Federal Claims for suits "upon any express or implied contract

with the United States." 28 U.S.C. § 1491(a)(1); see *Hercules, Inc.* v. *United States*, 516 U.S. 417, 423 (1996). And the Contract Disputes Act (CDA), 41 U.S.C. §§ 601-613, applies to "any express or implied contract * * * entered into by an executive agency for * * * the procurement of property" (Section 602(a)(2)), and allows a contractor to "bring an action directly on the claim in the United States Court of Federal Claims" (Section 609(a)(1)); see *Cessna Aircraft Co.* v. *Dalton*, 126 F.3d 1442, 1447 (Fed. Cir. 1997); see also *National Park Hospitality Ass'n* v. *Department of Interior*, 123 S. Ct. 2026, 2028-2029 (2003). Such contract claims against the United States are "grounded in the CDA." *Cessna*, 126 F.3d at 1447. But the Federal Circuit, in its most recent opinion below, ignored petitioner's right of action under the CDA and asked instead whether Section 8118 provided a private right of action.

When the operation of law has rendered a term of a purported contract invalid, a court will ask whether the party asserting the right to recovery can establish the existence of the contract based on well-understood contract principles. See *Hercules*, 516 U.S. at 423-424. Proof of an implied-in-fact contract requires proof of the elements of an express agreement – including consideration, mutuality of intent, and definiteness of terms. *Girling Health Sys., Inc.* v. *United States*, 949 F.2d 1145, 1146-1147 (Fed. Cir. 1991). This Court and lower courts have readily found that the contract is proved when it "has been wholly or partially executed and performed on one side." *Clark*, 95 U.S. at 542; see *Gould Inc.* v. *United States*, 67 F.3d 925, 930 (Fed. Cir. 1995) (*Gould II*) ("[A] contractor can be compensated under an implied-in-fact contract when the contractor confers a benefit to the government in the course of performing a government contract that is subsequently declared invalid."). Once the contract is proved, the illegal terms are replaced with implied terms as necessary for the agreement to be complete. See *ibid.* ("[I]t is only fair and just that the Government pay for goods delivered or services rendered and accepted under [the contract]."); *Clark*, 95 U.S. at 542.

The doctrine of contract reformation is also used in suits under the CDA. *Beta Sys., Inc.* v. *United States*, 838 F.2d 1179, 1185 (Fed. Cir. 1988). In *Beta Systems*, an economic price adjustment clause in a procurement contract was invalid for violating the Defense Acquisitions Regulation (DAR). *Id.* at 1184. If left untouched, the invalid clause would have inured to the government's benefit at the expense of the contractor. *Id.* at 1185. The court held that it was mutual mistake of the parties that allowed the illegal term to find its way into the contract, and that contract reformation was available to alter the price clause such that it would not violate the DAR. *Id.* at 1186.

B. *The Tortured Litigation Below Reflects the Confusion in the Federal Circuit Case Law.* The tortured history of this litigation, culminating in the panel decision below – holding that petitioner's right of recovery on its contract is determined by whether Section 8118 provides a private right of action – demonstrates the problems inherent in allowing the tangle of different rules promulgated by the Federal Circuit and the Court of Federal Claims to exist side by side.

The fact of the Navy's violation of Section 8118 in its contract with petitioner, as well as other contracts currently in litigation, is not a matter of dispute, but the issue presented in the petition – whether contract remedies are available to an aggrieved government contractor suing under the CDA – has utterly confounded the courts below. In five decisions producing nine separate opinions, the Federal Circuit and the Court of Federal Claims have variously held:

(1) the violation of Section 8118 rendered the contract void *ab initio*, and recovery should be allowed to the contractor on a *quantum meruit* basis (Court of Federal Claims, see Pet. App. 104a-135a);

(2) the violation rendered the contract void *ab initio*, and the Court of Federal Claims may not award equitable relief on a contract claim, so the case should be dismissed (see Pet. App. 75a-103a (Plager, J., over dissent by Newman, J.));

(3) despite the Navy's violation of Section 8118, the contract was *not* void *ab initio*, and on remand the Court of Federal Claims should consider what contract remedy is available to the contractor (see Pet. App. 33a-72a (Newman, J., with concurrence by Rader, J., and over dissent by Plager, J.));

(4) the valid contract contained a pricing provision violating Section 8118, but Section 8118 does not create a cause of action in favor of the aggrieved contractor, so the suit should be dismissed for failure to state a claim (Court of Federal Claims, see Pet. App. 21a-32a); and

(5) Section 8118 was violated, but is to be enforced through legislative oversight, rather than through a private right of action; also, the contractor waived any argument that the price clause of the contract is invalid, so the dismissal for failure to state a claim is affirmed (see Pet. App. 1a-18a (Rader, J., over dissent by Newman, J.)).

The multitude of different holdings, and inconsistency between the holdings, reflects the extraordinary uncertainty to which contractors are subjected when evaluating contracting opportunities.

The most recent (and, unless reviewed by this Court, case-dispositive) panel decision creates conflict with several of the Federal Circuit's own recent precedents. Presented with an opportunity to resolve the conflict by again taking this case *en banc*, the Federal Circuit denied the petition for rehearing. Pet. App. 19a-20a. As petitioner correctly observes (Pet. 22), such intra-circuit inconsistency takes on special importance – for purposes of this Court's review – when the case arises within the Federal Circuit's exclusive jurisdiction.

In *Barrett Refining*, another panel of the Federal Circuit – on which the author of the opinion below sat – took a functionally identical scenario and reached a result diametrically opposed to the panel decision below. *Barrett Refining* relied in part on the *en banc* decision in the litigation now before the Court to conclude that a contract with an illegal price term was

not void *ab initio*, and then held that recovery *was available* in *quantum valebant*. *Barrett Refining* involved four supply contracts between the plaintiff contractor and the United States to supply military jet fuel. *Id.* at 1058. The price term in the contracts involved a base price plus a price adjustment clause, but the price adjustment clause turned out to be unenforceable for violating the Federal Acquisitions Regulations. *Ibid.* After the contractor had fully performed under the contracts, and the base price of the contract was paid, the contractor sued seeking damages for the difference between the base price and the actual fair market value of one contract. *Ibid.* The United States counterclaimed, seeking to collect the amount that it had paid in excess of fair market value on the three other contracts. *Ibid.* The court held that the invalid price clause in the contract did not render the contract void *ab initio*, relying in part on the *en banc* decision in the litigation before the Court. *Id.* at 1060 n.2 ("The determination * * * that only the price escalation term was unenforceable and invalid, and that the entire contract was not invalid, is consistent with our case law." (citing *AT&T* v. *United States*, 177 F.3d 1368 (Fed. Cir. 1999) (*en banc*))). The *Barrett Refining* court then held that the parties were operating under a contract, so an implied price term could be discerned – and *quantum valebant* relief was available. *Id.* at 1059 (citing *Northrop Grumman Corp.* v. *United States*, 47 Fed. Cl. 20, 40-41 (2000)).[4] The court held that both the contractor and the government should be allowed to prove on remand that the fair market price differed from the base price that was paid.

Cessna Aircraft also *expressly rejects* the Navy's argument that a contractor "lack[s] standing to contest matters relating to

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[4] *Barrett Refining* relied on *Northrop Grumman* to support its holding that *quantum valebant* relief was an available remedy in a suit on an implied-in-fact contract. *Northrop Grumman* is one of the Section 8118-type cases that, were it still in litigation, would be forced to navigate the inconsistent Federal Circuit decisions in this case. See 47 Fed. Cl. at 35-36 (contract was subject to the versions of Section 8118 enacted for fiscal years 1990-1992).

the Navy's compliance with funding statutes" unless a "private right of action exists under the * * * Act with respect to such matters." 126 F.3d at 1447. The contractor in that case sued claiming loss because the Navy entered a contract in violation of the Antideficiency Act. Specifically, the contractor argued that the Antideficiency Act prohibited a particular price clause in a multi-year contract to provide training for "undergraduate naval flight officers." In rejecting the Navy's argument that the contractor must demonstrate the existence of a private right of action under the Antideficiency Act, the court held that the suit was brought under the CDA, on an implied-in-fact contract theory, and should be permitted. *Ibid.* "Cessna's claims [are] 'grounded in the CDA.' * * * The fact that Cessna argues that the Navy violated the Antideficiency Act and attendant regulations * * * [does] not mean that Cessna is seeking relief under the Antideficiency Act." *Ibid.* Although the court then held that the Antideficiency Act had not been violated (*id.* at 1452), Part II of its opinion (*id.* at 1447-1448) stood, until now, as the Federal Circuit's definitive rejection of the argument the Navy has now successfully pressed on a divided panel.

In *Gould II*, the contractor won a bid for a multi-year contract to produce radios for the Navy according to certain specifications. 67 F.3d at 927. The specifications were claimed to be inadequate, and the contractor incurred development costs significantly in excess of the fixed contract price. *Ibid.* The contractor argued that the Navy's failure to supply a "stable design" for the contract rendered the contract illegal under a statute requiring the agency head to find "'that there is a stable design for the property to be acquired and that the technical risks associated with such property are not excessive.'" *Ibid.* (quoting 10 U.S.C. § 2306(h)(1)(D)). The Navy argued in response that such an illegality meant that the contracting officer lacked *authority* to enter the contract. *Id.* at 929. But "'it is only fair and just that the Government pay for goods delivered or services rendered and accepted under'" the contract. *Id.* at 930 (quoting *United States* v. *Amdahl Corp.*, 786 F.2d 387, 392-393 (Fed. Cir. 1986)). The court held that, if the

contractor had rendered performance under a contract with an illegal price term, the contractor was entitled to relief under an implied-in-fact contract. *Ibid.*

Had the panel decision below followed, somehow distinguished, or even disagreed with the court's precedents allowing implied-in-fact contract relief – and specifically rejecting any rule that would require the term-invalidating statute to provide for a private cause of action – contractors and future litigants would at least have some definite rules by which to conduct their business. Another *en banc* opinion could have definitively reconciled the conflict. But the Federal Circuit's failure to clean its own house allows the uncertain state of the law to remain, and calls for review by this Court.

C. *The Failure To Apply Contract Doctrine To This Case Is Wrong.* Not only does the confused assortment of rules regarding what to do when a government contract includes an illegal term or illegal terms warrant review in order to provide clarity and consistency in the field, the decision below is manifestly incorrect and should be reversed. The fallacy in the lower courts' reasoning does not turn on their understanding of Section 8118. The fallacy is in over-complicating this case, which raises *nothing more* than a contract-law question of what measure of compensation is due to a contractor that has fully performed its obligations under a valid contract when the price term of the contract is declared illegal – or otherwise unenforceable (see *Clark*, 95 U.S. at 542).

"[W]here a parol contract has been wholly or partially executed and performed on one side, the party performing * * * will be entitled to recover such value as upon an implied contract." *Clark*, 95 U.S. at 542. Petitioner's right to a remedy in this case is a creature of contract law, to which the United States Government is subject when it chooses to enter into the domain of commerce. See *Mobil Oil Expl.*, 530 U.S. at 608; *Winstar*, 518 U.S. at 895 & n.39 (plurality opinion). Section 8118 plays a role – like the statute at issue in *Clark*, where a contract for the rental of the plaintiff's steamship was unenforceable because not reduced to writing – of stating that the price term in the con-

tract cannot be enforced as written. A suit on the contract is brought under the CDA, and jurisdiction is vested in the Court of Federal Claims by the Tucker Act. And the rules of contract law applicable to implied-in-fact contracts state that when one party to a contract has fully performed its obligations, and the other party has accepted performance while at all times acting as if under a contract, the fact that the contract contains illegal or unenforceable terms does not erase the contractor's right to recovery. See *Clark*, 95 U.S. at 544; *Gould II*, 67 F.3d at 930 (contractor should be given the opportunity to prove that it conferred a benefit while performing a contract with the government and that its performance entitles it to relief). In addition to implied-in-fact contract, the contract reformation doctrine permits a court to rewrite an invalid term in order to do justice to the parties' intent. See, *e.g.*, *LaBarge Prods., Inc.* v. *West*, 46 F.3d 1547, 1552 (Fed. Cir. 1995). The manifest injustice to petitioner and to myriad others similarly situated, including members of *amici* organizations, of permitting the government not to compensate contractors fairly for their products and labors, also counsels for this correct application of contract law.

In addition to the authorities discussed above, many decisions of the Federal Circuit and other federal courts permit recovery on an implied-in-fact contract when one or more terms of a contract are illegal by operation of law. See *Gould, Inc.* v. *United States*, 935 F.2d 1271, 1275 (Fed. Cir. 1991) (*Gould I*) ("A court may grant equitable relief under an illegal contract if the government received a benefit from the contractor's performance."); *Amdahl Corp.*, 786 F.2d at 395 ("[W]here conforming goods or services have been delivered by a contractor and accepted by the government, the contractor has been held entitled to payment."); *Urban Data Sys., Inc.* v. *United States*, 699 F.2d 1147 (Fed. Cir. 1983); *Campbell* v. *TVA*, 421 F.2d 293 (5th Cir. 1969). The Federal Circuit has also regularly granted contract reformation to correct illegality. See *Beta Sys.*, 838 F.2d at 1185 (reformation was appropriate when the price adjustment clause did not cover contractor's costs); *Applied Devices Corp.* v. *United States*, 591 F.2d 635, 641 (Ct.

Cl. 1979) (plaintiff contractor was entitled to an equitable reformation of the cancellation ceiling under the contract because the contract was made in violation of law); *Chris Berg, Inc.* v. *United States*, 426 F.2d 314, 315, 318 (reformation appropriate when the Navy violated regulations by failing to consider evidence of error resulting in an unreasonably low bid price).

Consideration of the outcomes of various contract disputes under the panel decision demonstrates the untenable nature of its holding. The panel held that (1) the price term of the contract was invalid, and (2) although the contract was not void *ab initio* (per the *en banc* decision), no cause of action was available under Section 8118, the statute rendering the price term invalid. Therefore, petitioner had no right to recovery. This holding readily allows the following two hypothetical scenarios to occur:

- Contractor and Navy enter into a fixed-price contract for $25 million, and contractor fully completes the contract but incurs only $5 million – not $25 million or anything close to it – in total costs. The Navy, using Section 8118 as a sword, refuses to pay more than $7 million. Under the lower court's holding, Contractor cannot recover the remainder due, even though it took the risk under the contract. Cf. *United States* v. *American Renaissance Lines, Inc.*, 494 F.2d 1059 (D.C. Cir. 1974) (holding that the government should not be allowed to hide behind its own failure to follow regulations and limit the private party to *quantum meruit* recovery).
- Contractor and Navy enter a fixed-price development contract that violates Section 8118. Contractor discovers that its costs will exceed the contract price, and the Navy refuses to restructure – so Contractor ceases working. When the Navy sues on the contract, the Contractor counter-claims arguing that the Navy drove it into default. Under the *en banc* decision below, the contract is enforceable, but under the panel

decision the Contractor has no claim for the violation of Section 8118 – so the Navy wins on both claims.

In both hypothetical situations, and indeed in every imaginable situation subject to the panel decision, the risk of an illegal term in a contract is borne solely by the contractor. Cf. *Johnson Mgmt. Gp. CFC, Inc.* v. *Martinez*, 308 F.3d 1245, 1259 (Fed. Cir. 2002) (Newman, J., dissenting in part) ("[T]he government bears neither the responsibility for its error nor the obligation to correct it to a mutually acceptable alternative."). By contrast to the results under the court's holding, an appeal to the contract-law doctrines of implied-in-fact contract and contract reformation produces consistent and defensible results. These rules that are available to contracting parties in other sectors of the economy should not be denied to defense contractors simply because they do business with the United States. Cf. *Mobil Oil Expl.*, 530 U.S. at 607 ("'When the United States enters into contract relations, its rights and duties therein are governed generally by the law applicable to contracts between private individuals.'"); *Johnson Mgmt. Gp.*, 308 F.3d at 1261 ("[T]he laws of contract and the rules of fair dealing do not evaporate when the government is a party. When a contract provision becomes illegal, whether due to later-discovered error or statutory enactment, the party that produced the illegality is liable for the injury caused thereby.").[5] Government contractors cannot maintain long-term operation without the certainty that the rule of law provides.

II. THE PANEL DECISION WARRANTS REVIEW BECAUSE OF ITS FAR-REACHING EFFECT AND THE INDEFENSIBLE BURDEN PLACED ON THE DEFENSE CONTRACTING INDUSTRY

A. *The Navy's Use of Fixed-Price Contracts Violated Congress's Express Directive.* Notwithstanding Section 8118

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[5] See also *John Doe Agency* v. *John Doe Corp.*, 493 U.S. 146, 158 (1989) (statement of Blackmun, J.) ("Simply because a party is a defense contractor does not mean that all doubts automatically are to be resolved against it * * *.").

(quoted at page 2, *supra*), the Navy entered into a large number of fixed-price contracts for systems development – contracts that are subject to Section 8118, or the section's equivalent in subsequent appropriations acts – *without* seeking or receiving prior written approval from the Under Secretary of Defense, *without any* determination that program risk had been reduced or that reasonable pricing could occur, and *without* regard for the fact that program risk in the illegal fixed-price-type contracts fell solely on the shoulders of the contractors. See Pet. App. 112a. No dispute exists that Section 8118 has been honored primarily in the breach. See Pet. App. 4a.

The Navy's failure was part of a long-running practice of turning a blind eye to the well-understood risks of fixed-price development contracting, and ignoring Department of Defense directives (DODD) and the relevant Federal Acquisitions Regulation (FAR). See FAR, 36 C.F.R. § 35.006(c); DODD 5000.1, ¶ D.9.g. Indeed, the FAR and DODD came about largely in response to the spectacular failure of fixed-price, "Total Package Procurement" contracts – including such well-known programs as the development and production of the F-14 aircraft, which resulted in substantial cost overruns and required "extraordinary relief" under the then-applicable Public Law No. 85-804, 72 Stat. 972 (1958). See generally Norman R. Augustine & Robert F. Trimble, *Procurement Competition at Work: The Manufacturer's Experience*, 6 YALE J. ON REG. 333, 345-347 (1989). Even so, in the mid-1980s the Navy renounced the FAR and DODD and returned to fixed-price development contracting, to which practices Congress directed its attention when enacting Section 8118: "The Committee is concerned about the Navy's policy regarding fixed-price contracting * * *." H.R. Rep. No. 100-410, 100th Cong., 1st Sess., at 203 (1987). The Conference Report accompanying Section 8118 stated: "The conferees also agree * * * with language encouraging the Navy to review its policy in particular." H.R. Conf. Rep. No. 100-498, 100th Cong., 1st Sess., at 623 (1987).

Congress's approach under Section 8118 was to impose after-the-fact, quarterly reporting requirements about the

Defense Department's compliance with the limitations on fixed-price development contracts, in order to avoid "the appearance of Congressional micromanagement." H.R. Conf. Rep. No. 100-498, at 623. Where Congress, when exercising its appropriations powers, relinquishes any active oversight role, it is incumbent on the judicial branch to ensure that constitutional separation of powers is not upset. See generally Kate Stith, *Congress' Power of the Purse*, 97 YALE L.J. 1343, 1386-1387 (1988) ("[T]he courts may be available to determine authoritatively whether the operating branch of government has complied with the specified limitations.") (citing *TVA* v. *Hill*, 437 U.S. 153 (1978)). In its decision below, the Federal Circuit panel abdicates its role.

B. *Other Cases Implicating Section 8118 and Other Statutes Are Placed in Uncertainty By the Panel Decision.* Certiorari is also appropriate because of the impact on the defense contracting industry, and the possible effect on the future ability of the Department of Defense to find private companies willing to undertake inherently speculative defense contracts.

Other contracts collectively worth hundreds of millions of dollars, including contracts involving members of *amici* organizations, also suffer the same malady under Section 8118. Some of those contracts are the subjects of litigation, involving issues identical to that raised in the petition, currently in the Court of Federal Claims – and are bound by the panel decision below. See Pet. 14 (citing three active suits by defense contractors against the United States raising the same issue as this case); cf., *e.g.*, *Northrop Grumman Corp.*, 47 Fed. Cl. at 26 (noting that "Congress precluded this type of contract during three years of its performance," and relying on the *en banc* decision below to hold that the available remedies are implied-in-fact contract, reformation, and enforcing the contract as it is written). The case currently before the Court is the first Section 8118 case to reach final resolution in the Federal Circuit. Hundreds of millions of dollars are at stake between these various cases. Review by this Court will place at rest an issue that promises to confound the lower courts and waste years and millions of dollars in litigation. See Pet. 14-15.

Beyond the cases implicating Section 8118 and its successors, cases regularly come to the Court of Federal Claims and the Federal Circuit raising analogous issues of illegality, demonstrating that the problem of illegal terms in government contracts is a recurring issue. In *Johnson Mgmt. Gp.*, 308 F.3d at 1253-1256, a contractual advance payments clause in a service contract violated both the applicable statute and the interpreting regulation, so the clause could not be enforced. Over a dissent by Judge Newman (*id.* at 1259-1262), who objected to placing the entire risk of the illegality on the contractor, the contract was enforced without the illegal clause, and without any remedy aimed at capturing the intent of the illegal clause, because "the * * * contract, as a whole, remained valid and enforceable." *Id.* at 1257 & n.4 (citing *Urban Data Sys.*, 699 F.2d at 1154). Both *La Gloria Oil & Gas Co.* v. *United States*, 56 Fed. Cl. 211, 224 (2003), and *Gold Line Refining, Ltd.* v. *United States*, 54 Fed. Cl. 285, 298 (2002), raise the issue from *Barrett Refining* –the measure of recovery available to an aggrieved contractor that supplied fuel to the U.S. military under a contract with an illegal price-adjustment clause. The final holding in the tortured litigation below submits all such cases that are active or yet to arise to uncertainty. See, *e.g.*, *Gould II*, 67 F.3d at 930; cf. Pet. 15 (discussing the Navy's recent arguments in *Gould* that the litigation before this Court established "the principle that funding statutes * * * are not judicially enforceable by contractors").

The defense contracting industry as a whole stands to suffer if the holding below stands. Contractors, including many members of *amici* organizations, that have rights to contract-law remedies in the face of illegal contract terms but are prevented from exercising those rights will suffer real and immediate economic loss. Section 8118 and subsequent versions of the statute were enacted to prevent just the concern that arises in this case – that of "the contractor * * * sustaining losses through unanticipated costs" on "development programs involving such a high degree of innovation that realistic pricing is not possible." S. Rep. No. 100-326, 100th Cong., 2d Sess.,

at 104 (1988). After violating the statute in this case and others, the Navy has been unsympathetic to requests to restructure the contracts (see Pet. App. 35a), and has attempted to impose on contractors the entire burden of the cost overruns. The decision below allows the Navy to do just that. In an industry where even contracts that do not result in protracted litigation over cost overruns and illegal contract terms can provide "perilously low levels of return for defense contractors," Augustine & Trimble, *supra*, at 344, the Navy's conduct in these cases is another risk that contractors can ill afford to bear.

Also, the Navy's reliability as a contracting partner is at stake in this litigation. During the time period when the contract giving rise to this litigation was entered, the Navy unabashedly entered into contracts with price terms violating statute (Section 8118 and its successors), FAR, 36 C.F.R. § 35.006(c), and DODD 5000.1, ¶ D.9.g. The Navy is able to require the contractor to perform its obligations fully, as the penalties for default on a government contract are extraordinary. Finally, when one or more of the contract terms are illegal, under the Federal Circuit rule the Navy escapes responsibility for its obligations to comply with the law. Contractors' willingness and ability to enter into and perform inherently speculative development contracts are, and will continue to be, compromised. See Augustine & Trimble, *supra*, at 340 (emphasizing the value of "[s]upplier loyalties stemming from good relationships" and adding, at roughly the time the contract in this case was entered into, that "relationships between the federal government and its prime contractor suppliers are more strained today than ever before"). Congress sought to avoid this very result, and the conference report noted the need to "maintain the government's credibility as a reliable business partner," and the challenges to doing so in the face of inappropriate use of fixed-price development contracts. H.R. Conf. Rep. No. 100-498, at 623.

C. *The Panel's Waiver Discussion Improperly Places the Burden of Compliance on the Contractor.* The court below suggested that petitioner had waived its claim by voluntarily

entering into a fixed-price development contract. Pet. App. 11a-14a. The waiver discussion is another red herring masking the salient issues that arise from the Navy's violation of Section 8118 – how to define a term that is rendered non-existent by operation of law.

The suggestion of waiver is also at odds with this Court's well-established rule. Circumstances certainly exist where a contractor's failure to raise an issue before entering into the contract should constitute a waiver of that issue. See, *e.g.*, *United Int'l Investigative Servs.* v. *United States*, 109 F.3d 734, 738 (Fed. Cir. 1997) (ambiguity in the specifications for the contract was patent and should have been raised before bidding on the contract). But this Court has consistently held that waiver "will not be permitted to thwart the purposes of statutes of the United States." *Sola Elec. Co.* v. *Jefferson Elec. Co.*, 317 U.S. 173, 176 (1942). A waiver rule regarding violations of Section 8118 directly contradicts this Court's authority, and could have the effect of writing the doctrine of contract illegality out of the law. If by entering into a contract with an illegal term, the parties waive the right to contest that term, no party with standing to sue could possibly contest the contract. Indeed, the panel's waiver discussion may yield another perverse result. This litigation is ample evidence that, without a suit on the contract by an aggrieved contractor, the Navy's violation of Section 8118 would go unchecked. To read Section 8118 as not *affirmatively providing* a cause of action is one thing; it is something else entirely to read it as *precluding* a cause of action grounded in principles of contract law or (under the waiver discussion) as placing the burden on the contractor to police the Navy's compliance with federal statutory law at the time of contracting. See Richard E. Speidel, *Contract Excuse Doctrine and Retrospective Legislation: The Winstar Case*, 2001 WIS. L. REV. 795, 818 & n.122 ("In most government contracts, the markets are limited to competition among private contractors seeking government business, and the government has superior bargaining power with which to call the shots.").

A new waiver rule applicable to violations of Section 8118, its successors, or other federal statutes will have very real and immediate consequences for defense contractors. Members of *amici* are alarmed that the panel below's waiver discussion might be read as Federal Circuit law.[6] Those contractors who remain in litigation against the United States over contracts subject to Section 8118 (and subsequent iterations of the statute), as well as contractors with provisions that are invalid by operation of other federal statutes, face having their claims thrown out because of improper invocation of a waiver rule. Contracts not yet bid will also be subject to the rule. The adhesion-contract negotiation process between the Department of Defense and contractors in effect, if not in fact, precludes a contractor from contesting specific terms of a contract during the bidding process. See Speidel, *supra*, at 818; Pet. 4. The speculative nature of development contracts, like the contract underlying this litigation, also prevents a contractor from reasonably assessing the cost and the risk involved in performing the contract. If entering into a contract without objecting to its terms constitutes a waiver, contractors may be relegated to the Hobson's choice of choosing not to bid or entering a contract relationship without legal protection.

CONCLUSION

For the foregoing reasons and those stated in the petition, the petition for a writ of certiorari should be granted.

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[6] In *Beta Systems*, the court specifically considered a waiver argument by the government and reached the opposite result from this case, holding: "[I]t is not controlling whether or not Beta or the government foresaw, or accepted the risk of failing to foresee, this defect in the index." 838 F.2d at 1186. Thus on this issue, as on the primary issue in the case, inconsistent Federal Circuit case law leaves parties in an unacceptable position.

Respectfully submitted.

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